

## **CHAPTER 1**

### **THE REENGINEERING OF ORGANIZATIONS**

**FAITH** IS THE SUBSTANCE OF THINGS HOPED FOR, THE EVIDENCE OF THINGS NOT SEEN.

The Holy Bible: The Epistle of Paul the Apostle to the Hebrews, 11:1

**FAITH** MAY BE DEFINED BRIEFLY AS AN ILLOGICAL BELIEF IN THE OCCURRENCE OF THE IMPROBABLE.

H. L. Mencken (1880 - 1956)

We have all seen the numbers. AT+T eliminates 40,000 jobs out of a total of 123,000. Lockheed cuts 15,000 jobs from a total of 30,000. And it's not just an American phenomenon: the merger of the Swiss pharmaceutical firms Sandoz and Ciba-Geigy will cut 14,000 jobs from their global workforce. Other companies eliminate workers gradually and quietly, so that the pain and notoriety are not as pronounced.

Many of us wonder if we're next on the list to be eliminated. The social and economic transformations driving the reengineering of organizations throughout the world have caused the loss of more than two million American jobs in the past five years, with further changes and reductions inevitable. What has caused this development? Are there alternative methods to make companies and other organizations more efficient?

The premise of this book is that organizations can be made more efficient without the wholesale elimination of people. Reengineering, the concept of re-designing an organization to save costs and time, and to improve service, attempts to determine and implement more efficient business processes.<sup>1</sup> Certainly those improved processes may require the elimination of some jobs, but they can also involve elements of the expense structure of an organization that have largely been ignored.

Our consulting work with several hundred organizations over the past 15 years has been keyed to **CASH**. By focusing on cash (or the older term, "liquidity") and the information and decisions which drive or are driven by that cash, we have saved corporations hundreds of millions of dollars annually. The procedures presented in this book were developed for the largest international organizations, including some 200 of the *Fortune* 500 companies and numerous large public organizations including governments, hospitals and museums.

While job cuts contributed to these savings, they were only a small element (typically one-fourth). Much of the savings were derived from the reduction of float, which is money in the process of collection, disbursement or other use. Other savings were from the use of lower priced bank and vendor services, the reduction of internal operating costs (other than people costs), and from other efficiencies. This can be done in your organization, and we're going to show you how to do it.

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<sup>1</sup>

The pioneering work in this field is by Michael Hammer & James Champy, *Reengineering the Corporation*, New York: HarperBusiness, 1993.

### **Management Vogues and Fashions**

Business and management practices, forever changing and evolving, tend to develop in trends. In pursuing the current fashion, organizations often behave like lemmings: they follow each other into the sea regardless of whether going into the sea is a good idea.

After the First World War, the trend was “scientific management” as pioneered by Frederick W. Taylor. The basis of scientific management was the time-and-motion study, which defined the precise method to accomplish each task and sub-task, the time, tools and training required, and the appropriate pay. Taylor's methods promised increased wages for workers and higher productivity for the corporation.

Another trend began in the the 1930's. Largely through the work of Elton Mayo at the Hawthorne plant of Western Electric, companies came to realize that the employee might have important input into the structure of his or her job. “Human relations” management became the fashion.

During the 1960's, the buzzwords were "self-actualization" (Abraham Maslow) and "hygiene factors" (Frederick Herzberg). Organizations began to believe that money, wages and a job were insufficient motivators.<sup>2</sup> Maslow developed his theory of a “hierarchy of needs,” with employees responding to the successive gratification of physiological (or basic) needs, security (or safety) needs, social (belonging to the work

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<sup>2</sup>Consult any good principles of management text for complete explanations. See, for example,

group) needs, ego (or self esteem) needs, and self-actualization (self-fulfillment) needs. Herzberg believed that basic work elements, such as company policies, wages and work conditions, were only capable of being "dissatisfiers" (when unfulfilled), and that satisfaction could only come through recognition, achievement and a sense of responsibility.

In order to keep up with their competitors in the 1970's, companies bought mainframe computers, even though most had no specific applications under development and limited programming or systems support. It wasn't until the computers were installed that management considered their functionality. Systems analysts and programmers were hired, and computer companies made massive profits from continually upgrading hardware capacity.

Today, in the age of instant communications, the trend is to track other companies' activities and performance, assess Wall Street's reaction, and then adapt the best and often the worst of these activities for their own organizations. Companies today are keenly aware of the perception of their potential performance by the investment banking community, and are anxious to do everything in their power to enhance shareholder value. Not-for-profit organizations are also under the microscope of public scrutiny, and charities and governments are cutting expenses, eliminating marginal services, and taking necessary measures to enhance contributor/taxpayer value.

Managers and other workers are caught in the middle of these pressures. Their jobs may be eliminated as organizations struggle to meet expectations. Companies failing to make forecast earnings are often subject to harsh treatment by the equity markets in the form of severe declines in the company's stock price. While the non-profit sector is not

subject to such extreme discipline, government and charitable organizations which do not efficiently accomplish their missions are subject to close scrutiny by their overseers, whether it be Congress, a board of directors or trustees, or another group.

The difference between the fashions of the past and today's reengineering/downsizing mania is that, for the first time in an economy which is not in a Depression, there is widespread job elimination. Earlier trends were relatively harmless: managers and workers retained their jobs while senior executives tinkered with production process and the organizational structure. In some cases, results actually improved!

What are the factors driving the current trend of reengineering and downsizing?

*Overcapacity Leads to Cost Reductions.* Technology and the globalization of markets has produced far more goods and services than can be absorbed in our present low growth economy. For example, estimates are that there are only seven buyers for every ten automobiles now produced. Deregulation and free trade eliminates artificial market barriers and allows companies to produce for sale in new markets worldwide.

In the U.S., industries formerly constrained or protected by governmental barriers --banking, public utilities, transportation, communications, oil, insurance--are now either entirely competitive or evolving toward competition. As trade barriers fall, prices seek market levels established by the global market instead of cost-plus levels set by government fiat. With market and profit protection going or gone, earnings can only be sustained by working smarter or eliminating expenses. This situation is irreversible for the foreseeable future.

*Employees Are Identifiable Cost Elements.* Workers are discrete cost units whose identities are easily determined. It's much simpler to determine potential cost savings from the elimination of a selected number of managers than it is to develop savings by internal improvements through outsourcing or other reengineering strategies.

These efforts require comprehensive knowledge of how a business process works, the analysis of that process, and the quantification of alternative approaches. With the compartmentalizing of jobs into strategic business units (SBUs) and functions, most managers have no broad perspective of their organization. Making it operate better is certainly much harder work than eliminating "X" number of jobs to accomplish the targeted savings.

Executives are constantly prodded by consultants and stock market analysts to become more efficient. If they refuse and earnings disappoint the markets, the company's stock price can be driven down 10-20% in a single day's trading. When the decision is finally made to cut, say, \$25 million from annual costs, it's much easier to downsize by 1,000 jobs (\$25 million divided by an assumed \$25,000 per employee) than to save \$25 million through reengineering.

*Management's Role Has Diminished.* The textbook definition of "management" includes decision-making, assembling elements of production and providing strategic direction. However, by the 1970's most managers spent their time collecting and analyzing data, and preparing reports about significant exceptions to plans and targets. The data included costs used in budgets, sales used in forecasts,

employee performance and error rates used in manufacturing reports, or as statistics used in other functional areas.

Other managerial activities include administering regulations, from occupational safety to equal employment opportunity to environmental issues. In addition, managers spend time on energy conservation, product safety and a host of other concerns that relate only indirectly to the mission of the enterprise.

The impact of the manager on the making and selling of product has clearly diminished. This phenomenon has sometimes been referred to as "the death of middle management." Grand strategy, assembling factors of production, decision-making--these are the domain of senior executives. Information technology has simplified the assembly of data, and the need for managers, except to respond to governmental regulation, has been significantly reduced.

*Managers are Expensive.* In selecting employees for downsizing, obviously the cost of each worker is a major consideration. Managers have been higher paid than technical or skilled personnel throughout the life of the modern corporation, but particularly since the installation of quantitative job evaluation and compensation systems.<sup>3</sup> Points are typically assigned to jobs based on technical and managerial skills and on training/education, with compensation geared to total points awarded in order to be competitive with the market for workers.

The various systems in widespread use are biased toward the rewarding of managers, with the result that managers often receive greater compensation than

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<sup>3</sup>For a more complete discussion of this phenomenon, see Robert M. Tomasko, *Downsizing, Reshaping the Corporation for the Future*, 1987, revised 1990, New York: Amacom, pp. 17-20 and pp. 279-282.

other employees. Furthermore, such bias causes everyone to want to be a manager, and more managerial positions are created to accommodate workers deemed critical to the success of the organization.

### **What Are the Results?**

The widespread dismissal of managers and workers to meet the profitability expectations of Wall Street has had a variety of unfortunate consequences. The nature of these consequences largely depends on the specific structure of the organization.

Many organizations have developed an operationally decentralized, SBU or profit center structure, with specific goals and profitability expectations. The usual operating process is to provide the necessary assets for these businesses to function, including access to capital equipment, people, product development resources, systems support and sales people. The business or not-for-profit manager organizes these functions as best as he or she can, has successes and failures, learns from these experiences, and generally carries forward the business mission of the corporation.

Other businesses, usually offering fewer product lines or less geographically dispersed operations, utilize a more centralized, functional form of organization. This structural form typically offers less autonomy to managers who may be responsible for a portion of a large production or marketing function. Such organizations have the advantage of more "focused" control over the activities of the business, while avoiding the duplication of functional activities (as would occur in an corporation with numerous



SBU). According to Alfred Chandler, the optimal organizational form (the structure) follows the grand strategy selected.<sup>4</sup>

When downsizing occurs and managers are eliminated, resources are reassigned to other uses and purposes, or are left to drift. Many reengineering survivors, who once were part of a team of managers and workers, are now expected to either conduct the business of the team or to accept reassignment to other responsibilities. How do they react to this?

*The Downsizing Announcement and Survivor Guilt.* During a corporate downsizing, much of the energy of the workforce is diverted to speculation about personnel decisions by the organization. Who will stay and who will go become far more important issues than can we ship on time, or can we sell enough product? Many survivors are paralyzed by feelings of guilt that they were spared while their co-workers were not. This guilt frequently results in lasting emotional distress, including uncontrollable crying, depression and difficulty in concentrating on daily tasks. Furthermore, the survivor often expects that his or her status will change the next time, as inevitably seems to occur in many large organizations.

Few survivors will champion new products or programs, and organizational initiative is often destroyed. The prevailing attitude may change to "hunkering down" in order to not be seen, rather than the development of new ideas and approaches to problems. It's not hard to imagine that focusing on global strategy becomes secondary to worrying about personal survival.

*Sabotage.* Managers and workers may believe that an unwritten "social contract" exists between the employer and themselves, which states that a lifetime job is

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<sup>4</sup>*Strategy and Structure*, MIT Press, 1962.

guaranteed as long as the employee continues to exert all necessary efforts for the success of the enterprise. Downsizing often eliminates jobs *en masse*, without regard for the efforts of specific employees, their length of service, their loyalty or other factors. The resulting anger of the terminated employee, or of his or her survivor friend, may lead to attempts at sabotage. Such actions can include the destruction of files, records and orders, theft, refusal to complete required tasks, adverse comments to the news media and to customers, and other negative actions.

Companies are often advised to require terminated employees to leave the premises immediately so that the opportunity for sabotage is limited. In those situations, outplacement facilities and counselling may be made available through employment agencies. Other organizations place reengineered workers in a special office area that is part of the physical premises of the company. This allows them to pursue new positions while ostensibly employed by the downsizing firm. Sometimes the saboteur is the survivor, if he or she is not too despondent to act!

*Experience Gap.* The dismissal of managers inevitably includes those with long service in the organization who have seen and can help solve the unusual problem, or know where vital resources can be found. These workers are included in the downsizing often because their salaries are higher than more junior employees, or because a strategic decision has been made to eventually reduce or eliminate particular SBUs. Without the knowledge base that these experienced people provide, the organization often muddles along at a less than efficient rate.

*Political Maneuvering.* Managers and workers develop political alliances with bosses and peers in the pursuit of favorable treatment to advance their career goals.

During downsizing, the maneuvering to ally with executives in power can become the primary task of work, more than producing and selling widgets or making a profit. The perception that influence or favored treatment may mitigate termination can cause the mission of the organization to be overwhelmed by political activity.

Given these reactions to a downsizing action, how can the organization successfully continue toward the accomplishment of its mission?

### **Can Reengineering Accomplish Its Objectives?**

While reengineering holds significant promise, much of it remains unfulfilled. Even a leading expert admitted that goals set in specific reengineering efforts failed by as much as 30%, and that "...the revolution we started has gone, at best, only halfway. I have also learned that half a revolution is not better than none. It may, in fact, be worse."<sup>5</sup> Here are some outcomes from the reengineering revolution, as observed in our consulting work.<sup>6</sup>

The manufacturing process of a **consumer durable goods** company was reengineered toward reducing production time and inventories, and improving gross margins. The project involved integrating separate SBU's in several production sites and eliminating certain redundant functions, including some personnel and overhead. The project failed when the vice-presidents of the SBU's realized that their independence was being threatened and that cooperation toward the common mission would be required.

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<sup>5</sup>Champy, *Reengineering Management*, page 3.

<sup>6</sup>Throughout this book, examples are provided from Sagner/Marks consulting engagements of client behavior. To retain confidentiality, all organizational descriptions have been disguised.

A diversified **financial services** company had developed several investment departments in various locations, none of which were of sufficient size to warrant independent operations. The company was advised to integrate the various investment departments and to develop economies through the maintenance of self-contained bond and equity trading floors and a comprehensive cash forecasting operation. The recommendation was ignored because the investment function had previously provided large returns to the company, and it was unwilling to consider an alternative plan.

An international **aviation** company considered reengineering its parts distribution system in order to decrease the number of locations and employees and to concurrently lessen inventory held awaiting sales. The project required the senior executive of the distribution business to agree to the elimination of portions of his "empire" and to be counselled by outsiders (consultants) regarding optimal surviving locations and inventory. The project failed because of his resistance.

In each of these cases, the failure of the reengineering effort led to far more radical actions. The consumer durable goods company eventually moved the entire production process to another country, citing lower costs to manufacture. This resulted in the loss of 2,000 jobs and the closing of the SBU's. The financial services company was absorbed in a takeover and new senior management was brought in. The investment groups and numerous other businesses were eliminated, with the loss of 10,000 jobs. The aviation company's board of directors fired senior management, including the chief executive officer, and sold parts of the company to a competitor.

There are several common themes in these and similar case examples:

*Self Preservation.* Managers and workers do not willingly cooperate to reengineer a process when their authority and prestige are threatened. Appeals to the mission of the organization or the common good are often useless, and even if agreed to, may be subverted by covert acts of resistance.

*Refusal to Change.* Managers and workers are comfortable with the processes they know and uneasy about change. When ordered to comply, "shadow" or parallel systems and procedures may be maintained to accomplish work.

*Resistance to Advice.* Managers and workers tend to resist any advice from those perceived to be outsiders, on the grounds that only SBU personnel can be the experts in their businesses. This principle holds true even within the organization, such as when staff (advisory) personnel attempt to counsel line employees, those directly responsible for production and marketing activities. It is an iron rule that consultants are distrusted and ignored in many organizations.

The clear lesson is that when employees believe that their interests lie in preserving the *status quo*, they're likely to resist the reengineering of their work or their organization. The challenge, discussed throughout this book, is to gain acceptance for positive change without the drastic surgery of downsizing or the sale of the business.

### **The Cashflow Reengineering Solution**

There is now a growth industry in reengineering consulting and publishing, and, unfortunately, in the strategy of eliminating jobs to make financial results attractive for

shareholders and other constituent groups. The popular literature in this field generally provides various platitudes and cases illustrating how-to or how-not-to-do reengineering.<sup>7</sup> The constant refrain, however, is that no two situations are the same and that the process is very difficult.

Reengineering books provide little information on specific procedures to use in this work. No generalized methodology has been developed. The most glaring flaw in the existing literature may be the attempt to explain "lessons" from specific cases. Many different disciplines are involved in a reengineering effort (finance, production, systems, accounting, etc.) making any lesson difficult to apply from Organization A to Organization B. One writer, after suggesting that a major mistake is in over-analyzing the organization's existing processes, devoted an entire chapter to the process of selecting a consultant! Apparently, no executive could be clever enough to manage that process on their own.

Our message is somewhat different: cashflow reengineering is not voodoo, it's not a mystery. There are a limited number of alternatives to pursue and specific analytical processes that will lead you to the right one. The result of that evaluation is a quantitative measurement--cash--which can be saved by implementing the proposed change. Estimates of potential benefits are based on specific internal improvements and/or outsourcing. Measurements are fairly precise: the value of float or the savings between

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<sup>7</sup> In addition to those previously cited, see James Champy, *Reengineering Management*, New York: HarperBusiness, 1995; and Michael Hammer and Steven A. Stanton, *The Reengineering Revolution*, New York: HarperBusiness, 1995. Reengineering books are also oriented to using various automation tools to replace manual processes; see, e.g., Cheryl Currid, *Reengineering Tool Kit*, Rocklin CA: Prima Publishing, 1994, which discusses automated input techniques, e-mail, work flow automation, and similar applications.

the current process and the alternative. In our experience, senior executives and middle managers accept such reengineering recommendations for a number of reasons:

*Large Attainable Savings.* A good example is outsourcing disbursements to a bank (see Chapter 8), resulting in savings of \$1.50 or more per paper transaction. A company issuing 5,000 checks monthly can save nearly \$100,000 each year! Banks and vendors have the service in place with numerous current clients, and implementation time is usually only three or four months. Perhaps most important, there's no built-in opposition to this decision, because no one SBU is totally responsible for the check disbursement function. See Table 1-1 for examples of cashflow reengineering client savings from internal improvements and outsourcing.

*NO Massive Job Losses.* In this same example, the savings are derived from eliminating inefficient internal processes, including the costs of mainframe computer time, pre-printed check stock, bursting and signing, the excess of first class postage over the lowest bulk pre-sort rate, and the relatively inefficient process of internal check reconciliation. Most important, the savings from lost jobs would only be about 25% of the total, equivalent to one person (considering wages and fringe benefits). There is no surer path to destroying morale and producing failure than to eliminate large numbers of jobs. The social contract is destroyed and the concept of an organizational mission is compromised. The experiences cited in Table 1-1 involved limited job elimination and, certainly, no loss of the organizational work ethic. If anything, the competitive desire to compete and win was enhanced at each company.

*NO Theory or Faith Requiring a "Religious" Acceptance.* Throughout the existing literature, there is a recurring idea of dependence on faith. One reference states that the proper approach is not to reengineer *work*, the operations or tasks performed by managers and workers, but to reengineer *management*, the process of organizing and directing scarce resources (*e.g.*, land, labor and capital) into a productive enterprise. The author claims that the reengineering of a work process will fail unless the managerial attitude supervising that work process is also reengineered.<sup>8</sup> Attitude adjustment is for psychiatrists, psychologists and bartenders. Our goal in this book -- and your job -- is to develop the optimal process to accomplish a worktask, including assembling the necessary resources to finish that task. To continue our disbursement outsourcing reference, no faith or psychology is required. The banks/vendors bid on the service and you accept or decline. A consultant can analyze your internal costs, and can assist with the selection from alternative bidders. Most important, you can get there yourself with a little effort.

### **Managing Cash and Creating Customers**

Changes are occurring in organizations of all sizes and types, not just to the AT&T's and Lockheeds of the world. The purpose of this book is to assist managers to do a better job assembling their resources and making the correct decisions for becoming

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<sup>8</sup>Champy, *Reengineering Management*; see footnote 7.



more efficient. Banking and vendor services are a major focus, as well as improving existing processes.

Shakespeare's fiery warrior "Hotspur," on the eve of battle with the armies of King Henry IV, spoke of "The very life-blood of our enterprise" (*King Henry the Fourth*, Part I, act IV, sc. i). In addition to your efforts to create customers and emphasize quality, we want you to focus on CASH as the life-blood of your enterprise.

We begin in Chapter 2 with a discussion of cashflow reengineering and management principles. This is critical because, in the traditional workflow of a corporation, no one manager has direct responsibility for cashflow even though it is the organization's most critical asset. Several popular systems for defining business objectives have made the evaluation of business and managerial performance confusing; we explain why cashflow reengineering is the appropriate goal for any organization.

Chapter 3 explains how the careful analysis of current processes is necessary to establish a benchmark for potential changes. The next steps are to determine if internal improvements are feasible or if the process should be outsourced. Chapter 4 discusses the outsourcing alternative, while Chapters 5 - 9 address the various elements of internal improvements. Chapter 10 reviews risk management and control procedures, and our summation, Chapter 11, outlines the OPQR paradigm in management.